

Internal Revenue Service
memorandum

TL-N-498-88

CC-TL TS

HEARD

date: JAN 15 1988

to: District Counsel, San Jose W: SJ

from: Acting Director, Tax Litigation Division CC: TL

subject: Settlement Of TEFRA Case By Notice Partner ~

This responds to your request for technical advice dated October 7, 1987. You asked us to expand upon the procedure for settling TEFRA cases contained on Page 34 of the enclosed "QUESTIONS AND ANSWERS ON TEFRA PARTNERSHIP PROCEDURES".

ISSUE

What procedures should be followed in settling a litigated TEFRA partnership case where a notice partner is the only partner to file a petition in the case and no other partner files a notice to participate or to intervene.

CONCLUSION

A decision document based on a stipulation of settlement signed by the notice partner will probably act as a final decision adjusting the Final Partnership Administrative Adjustment and, thus, will be binding on all nonparticipating partners under I.R.C. §§ 6226(c) and 6626(f). A motion should be filed requesting that the Court enter the decision (see sample attached). The motion informs the Court that the Service intends to make assessments with respect to all remaining partners based on that decision. The motion requests in the alternative that the Court issue an order to show cause to nonparticipating partners requiring them to appear and state why the decision should not be entered. Once the decision of the Court is entered, assessment may proceed on the basis of the entered decision and the partners' returns. No additional documents need to be obtained from nonparticipating partners (such as a Form 870-P) in order to make the assessments.

008399

DISCUSSION

I.R.C. § 6226(c)(1) and (2) state that "[i]f an action is brought under subsection (a) or (b) with respect to a partnership for any taxable year . . . each person who was a partner in such partnership at any time during such year shall be treated as a party to such action and . . . the court having jurisdiction of such action shall allow each such person to participate in the action." Section 6226(f) states that a "court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the taxable year to which the notice of final partnership administrative adjustment relates and the proper allocation of such items among the partners." I.R.C. § 6231(b)(1)(C) states that partnership items "shall become nonpartnership items as of the date . . . the Secretary enters into a settlement agreement with the partner with respect to such items."

The effect of a stipulated settlement in a docketed TEFRA partnership case on nonparticipating partners is not explicitly addressed by the statute, nor has the issue as yet been litigated. Under I.R.C. § 6224(c)(1), with respect to TEFRA partnerships, settlement agreements are only binding on the parties to the agreement. There are two exceptions to this provision. Section 6224(c)(1) provides that an indirect partner is bound by any such agreement entered into by a pass-thru partner unless the indirect partner has been identified as provided in section 6223(c)(3). Section 6224(c)(3) provides that a partner who is not a notice partner shall be bound by any settlement agreement which is entered into by the tax matters partner, and in which the tax matters partner expressly states that such agreement shall bind the other partners.

Technically, if all the Tax Court Rule 246 parties (active partners) settle out of a case, this settlement could result in the dismissal of the action. 1/ Dismissal would occur for

1/ Tax Court Rule 246 parties are defined as partners who have either filed a petition, elected to intervene (in the case of the TMP), or who have elected to participate in the action.

lack of prosecution if no other partner filed an election to participate and continued to litigate the case, and if the TMP did not choose to prosecute the action in a representative capacity on behalf of the nonsettling partners. Under section 6226(h), "the decision of the court dismissing the action shall be considered as its decision that the notice of final partnership administrative adjustment is correct." In such an instance, nonparticipating partners who have not previously settled 2/ could be bound by the original FPAA as upheld by the Court.

I.R.C. § 6224(c)(2), however, provides that "the Secretary shall offer to any other partner who so requests settlement terms for the partnership taxable year which are consistent with those contained in such settlement agreement." Thus, the nonparticipating partner could, where a docketed case is settled, request a consistent settlement or, alternatively, file a motion to participate out of time and continue to litigate the suit pursuant to section 6226(c)(2).

It is our position that, unless a nonparticipating party files a motion to participate out of time and the Court grants such motion, the Court should enter a decision consistent with the settlement agreement which will be binding on all nonparticipating partners pursuant to section 6226(f). Although, under section 6226(f), the Court only has jurisdiction over partnership items and a stipulation of settlement will convert these items to nonpartnership items, our position is that the statutory automatic conversion to nonpartnership items does not deprive the Tax Court of jurisdiction to enter a decision. The alternative is to treat the case as being dismissed due to default which, in turn, would uphold the FPAA without adjustment with respect to nonparticipating partners under section 6226(h).

A procedure similar to the procedure recommended herein has been submitted to the Tax Court in the form of a proposed Tax Court Rule 248 (see attached). Under the proposed rule, nonparticipating partners will be notified of the proposed settlement and given an opportunity to file an election to participate out of time. Until the Tax Court formally adopts this or another procedure, we recommend that a motion be filed asking that the decision document be entered. The motion should

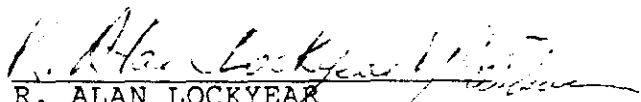
:

2/ I.R.C. § 6226(d)(1)(A) states that, section 6226(a) "shall not apply to a partner after the day on which . . . the partnership items of such partner for the partnership taxable year become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231."

also inform the Court that we intend to assess the nonparticipating partners on the basis of the stipulated decision. The motion should request, in the alternative, that the Court issue an order to show cause to the nonparticipating partners requiring them to appear and state why the decision should not be entered. Once the decision of the Court is entered, assessment may proceed on the basis of the stipulated decision and partners' returns. No additional documents need to be obtained from the nonparticipating (inactive) partners (such as a Form 870-P) in order to make the assessments.

PATRICK DOWLING

By:


R. ALAN LOCKYEAR
Senior Technician, Reviewer
Tax Litigation Division